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No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INC. AND RICHARD C. NOTEBAERT, ,

Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., ET AL.

Respondents.

On Writ Of Certiorari to the United States Courts of Appeals for the Seventh Circuit

AMICUS CURIAE BRIEF OF THE AMERICAN ASSOCIATION FOR JUSTICE IN SUPPORT OF RESPONDENTS

LEWIS S. EIDSEN
1050 31st St., N.W.
Washington, DC 20007
(202) 965-3500
President,
American Association
For Justice

JEFFREY ROBERT WHITE *
Center for Constitutional
Litigation, P.C.
1050 31st St., NW
Washington, DC 20007
(202) 965-3500
*Counsel of Record

Attorney for Amicus Curiae

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IDENTITY AND INTEREST OF *AMICUS CURIAE*

The American Association for Justice ["AAJ"], formerly the Association of Trial Lawyers of America, respectfully submits this brief as *amicus curiae*. The parties have filed blanket letters of consent to the filing of amicus briefs with this Court.[1]

AAJ is a voluntary national bar association whose approximately 50,000 trial lawyer members primarily represent individual plaintiffs in personal injury cases and other civil actions, including securities fraud suits. Throughout its 40-year history, the association has championed the constitutional right to trial by jury as an essential part of democratic government, by which ordinary citizens hold accountable those who have wrongfully caused harm.

SUMMARY OF THE ARGUMENT

1. In 1995, Congress determined that the Federal Rules of Civil Procedure, specifically notice pleading provisions that have greatly eased the burden for litigants seeking legal redress on the merits of their grievances, did not adequately protect defendants in private securities fraud actions. The lawmakers found no cause for concern in jury verdicts imposing liability for fraudulent conduct. Indeed, Congress expressly noted the valuable role of such litigation in deterring and compensating the victims of illicit stock manipulation.

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[1] Pursuant to Rule 37.6, Amicus discloses that no counsel for a party authored any part of this brief, nor did any person or entity other than Amicus Curiae, its members, or its counsel make a monetary contribution to its preparation.

Congress was instead concerned with the filing of lawsuits that would not, and were not intended to, reach trial. "Strike suits," filed after a drop in a company's stock price with little or no indication of wrongdoing, subject defendants to "fishing expeditions" – broad, disruptive, and expensive discovery that exerts pressure on innocent defendants to settle baseless claims.

To rid the civil justice system of such abuses, Congress amended Section 10(b) of the Securities Exchange Act of 1934 to require that the complaint in a private suit under the Act "state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind." The statute does not, however, answer the question how "strong" an inference must be to survive a motion to dismiss under Rule 12(b)(6).

The court of appeals below answered that question in a fashion that strikes the balance Congress intended, allowing dismissal of baseless lawsuits while permitting meritorious cases to proceed to discovery and trial. A securities fraud complaint satisfies the "strong inference" standard "if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." That standard is familiar to federal courts, mirroring the standard for surviving a motion for summary judgment or directed verdict. More importantly, the standard is faithful to the constitutional command in the Seventh Amendment that the right of trial by jury shall be preserved.

2. Heightened pleading requirements, including those at issue here, clearly implicate Seventh Amendment concerns. Congress can, of course, define the proof requirements for liability under the

substantive law. Dismissal under fact pleading requirements that do no more than reflect the proof requirements necessary to establish liability does not deprive a plaintiff of the jury right.

Petitioner in this case, however, argues for a pleading standard that is higher than the standard of proof of scienter under the Securities Act. Authorizing judges to dismiss cases that otherwise would be entitled to reach the jury would clearly violate the Seventh Amendment, whose core purpose is to maintain the proper roles of the judge and the jury on disputed questions of fact.

The history of the Seventh Amendment and the Founders' passionate commitment to the jury has led courts to be vigilant in guarding this fundamental constitutional guarantee. The court of appeals properly construed the heightened pleading standard to avoid infringement of the jury right.

3. Petitioner asks this Court not only to impose a higher standard of "strong inference" than the court of appeals articulated, but also to engraft upon that standard three "principles" for judges ruling on motions to dismiss. None of these principles finds any support in the statutory text, and all would infringe upon the right to a jury trial.

Petitioner's first principle would require the judge to consider not only facts and inferences favorable to plaintiff, but also "contrary inferences arising from other facts before the court." Currently, a judge looks to the facts facts in the complaint, the attachments thereto, and perhaps to undisputed matters that may be the subject of judicial notice. To the extent that Petitioner's principle would permit judges to consider factual matters advanced by the *defendant,* in the motion to dismiss or otherwise, it

should be rejected. Congress gave no indication in the PSLRA that it intended such a jarring departure from long-settled practice. Indeed, Congress made provision in Rule 12(b) for considering materials in addition to the complaint by treating the motion as a motion for summary judgment under Rule 56. To authorize judges to transform a Rule 12(b)(6) motion into a trial by affidavit on the merits would clearly violate the Seventh Amendment.

There is similarly no statutory support for Petitioner's second "principle," that factual allegations of the defendant's motive are especially important, or even essential, to a securities fraud complaint. Congress neither prescribed nor prohibited any particular method of pleading scienter. To dismiss a complaint that does not allege motive but alleges other facts from which a jury could infer the requisite state of mind would deprive the plaintiff of the right to submit this factual question to the jury.

Finally, Petitioner would require factual allegations that yield not merely a "strong inference," but "the strongest of all possible inferences" of scienter. That is, if the alleged facts give rise to a strong inference that defendant acted with fraudulent intent, but may be viewed as yielding an equally strong inference of innocent intent, the complaint must be dismissed. There is no statutory text to support such a comparative test. It necessarily involves the judge in assessing the weight of competing inferences from facts, which is the responsibility of the jury.

Moreover, weighing competing inferences is not necessary to carry out the purpose of the PSLRA. Where, as here, allegations are ambiguous due to

missing facts, particularly facts within the control of the defendant, Rule 12(b) permits the judge to treat the motion as one for summary judgment and allow limited, focused discovery under Rule 56(f). The court could resolve the ambiguous factual allegations while protecting defendants against broad and unfocused "fishing expeditions."

ARGUMENT

I. THE COURT OF APPEALS APPLICATION OF THE HEIGHTENED PLEADING STANDARD OF THE PRIVATE SECURITIES LITIGATION REFORM ACT IS CONSISTENT WITH THE INTENT OF CONGRESS.

A. Congress Intended the Heightened Pleading Standard to Allow Early Dismissal of Baseless Lawsuits While Preserving the Viability of Meritorious Actions.

Pleadings, starting with the complaint, are the path to the courthouse. By 1938, common law and statutory code pleading had become an unacceptably intricate, often inscrutable puzzle. Litigants reached the courthouse, if at all, due to counsel's art, arcana and sheer good fortune, rather than the merits of their cases. *See generally*, Charles E. Clark, *Simplified Pleading*, 2 F.R.D. 456, 458-60 (1943).

The Rules of Civil Procedure greatly smoothed that path, requiring of the plaintiff only a "short and plain statement of the claim" for relief, sufficient to put the defendant on notice of the nature of the claim. Fed. R Civ. Pro. 8(a); *see Conley v. Gibson*, 355 U.S. 41, 47 (1957).

The Rules look instead to "summary judgment and control of discovery to weed out unmeritorious claims." *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168-69 (1992). Rule 9(b) makes special provision for cases alleging fraud or mistake, requiring that "the circumstances constituting fraud or mistake shall be stated with particularity." Even in those cases, however, intent and other conditions of mind "may be averred generally." Fed. R. Civ. Pro. 9(b).

In 1995, finding that these Rules did not provide adequate protection for innocent defendants in private securities fraud lawsuits, Congress enacted the Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 ["PSLRA"]. Among other changes, Congress added new section 21D(b)(2) to Section 10(b) of the Securities Exchange Act of 1934 to impose heightened pleading requirements in private securities lawsuits.

Significantly, Congress was not concerned with improper or inordinately large or numerous jury verdicts. Indeed, Congress explicitly emphasized the value of such litigation:

> Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.

H.R. Conf. Rep. No. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. at 730.[2]

Congress's aim was rather to "discourage frivolous litigation." *Id.* at 32, 1995 U.S.C.C.A.N. at 731. Specifically, the lawmakers saw the need for early dismissal of baseless "strike suits," described as

> the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action.

H.R. Conf Rep. No. 104-369, at 37, *reprinted in* 1995 U.S.C.C.A.N. at 736.

Defendants in such cases become the objects of "fishing expeditions," wide-ranging and costly discovery with no real basis for believing that evidence of fraud would be uncovered, but which "impose costs so burdensome that it is often economical for the victimized party to settle." *Id.* at 31, *reprinted in* 1995 U.S.C.C.A.N. at 730.

Such abusive lawsuits do not – and are not intended to – reach a jury for ultimate resolution. The evil Congress sought to address was the coercion of innocent defendants into settling such cases, based on the economics, not the merits, of their defense. *Id.*

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[2] This Court likewise recognizes that private suits further an "important securities law objective." "The securities statutes seek to maintain public confidence in the marketplace. They do so by deterring fraud, in part, through the availability of private securities fraud actions." *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (citation omitted).

To rid the civil justice system of baseless suits prior to discovery, the PSLRA requires that a complaint alleging securities fraud under the Act specify "each statement alleged to have been misleading" along with "the reason or reasons why the statement is misleading." 15 U.S.C. § 78u-4(b)(1). In addition, the complaint must,

> with respect to each act or omission alleged to violate this chapter, state with particularity *facts giving rise to a strong inference* that the defendant acted with the requisite state of mind.

15 U.S.C. § 78u-4(b)(2) (emphasis added). All discovery is stayed while the motion is pending. 15 U.S.C. § 78u-4(b)(3)(B).

As Petitioner recognizes, "Congress 'sought to strike the appropriate balance between protecting the rights of victims of securities fraud and the rights of public companies to avoid costly and meritless litigation.'" Pet. Br. at 30 (quoting S. Rep. 104-98 at 10. Congress certainly intended "to permit the dismissal of frivolous cases at the earliest feasible stage of the litigation, thereby reducing the cost to the company, and by derivation, to its shareholders, in defending a baseless action." *Bryant v. Avado Brands, Inc.*, 187 F.3d 1271, 1278 (11th Cir. 1999).

Congress just as certainly did not mandate trial by affidavit for meritorious cases. Such an interpretation would not only contravene Congress's expressed intention that such litigation be encouraged, but would be a constitutionally suspect incursion on the litigant's right to trial by jury. As this Court emphatically stated:

> Our holding that the clear-and-convincing standard of proof should be taken into account in ruling on summary judgment motions does not denigrate the role of the jury. It by no means authorizes trial on affidavits. Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge, whether he is ruling on a motion for summary judgment or for a directed verdict. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.

Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 255 (1986). *See also Poller v. CBS, Inc.*, 368 U.S. 464, 473 (1962) (Clark, J.) (summary procedures "should be used sparingly" in litigation "where motive and intent play leading roles [and] the proof is largely in the hands of the alleged conspirators. . . . Trial by affidavit is no substitute for trial by jury which so long has been the hallmark of 'even handed justice.'").

B. The Court of Appeals Struck the Proper Balance, Allowing Dismissal of Baseless Lawsuits While Preserving the Right to Trial By Jury For Meritorious Claims.

Congress left the application of its standard in particular cases to the federal courts. Section 78u-4(b)(2) neither prescribes nor prohibits the kinds of allegations or inferences that satisfy the heightened pleading standard for scienter. Nor does the text answer the very practical question facing judges, including the court in this case: How strong is a "strong inference"?

The answer articulated by the Seventh Circuit in this case is both precise and elegant. A securities fraud complaint satisfies the "strong inference" standard "if it alleges facts from which, if true, a reasonable person could infer that the defendant acted with the required intent." *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 602 (7th Cir. 2006).

The Solicitor General mischaracterizes this standard as equivalent to the standard before passage of the PSLRA. Br. for the United States at 23. To the contrary, the court of appeals carried out Congress's command to impose a far higher burden of fact pleading than courts had required under Rule 9(b), which allows fraudulent intent to be "averred generally." *See, e.g., In re GlenFed, Inc. Sec. Litig.*, 42 F.3d 1541, 1547 (9th Cir. 1994) ("[P]laintiffs may aver scienter generally . . . that is, simply by saying that scienter existed.").

The court of appeals' standard is readily familiar to federal judges, echoing the standard required to survive a motion for summary judgment under Rule 56 or, at a later stage, judgment as a matter of law under Rule 50. Such judicial dispositions will not lie "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson*, 477 U.S. at 248. Nor may the case be taken from the jury "[i]f reasonable minds could differ as to the import of the evidence." *Id.* at 250. Federal courts have applied this standard in numerous cases. *See* 9A Wright & Miller § 2528, at 288-289 & nn.2-3 (2d ed. 1995) (judgment as a matter of law); *id.* at 10A, § 2713.1 (summary judgment).

The court of appeals' standard is strong enough to serve as a barrier to strike suits and fishing expeditions that do not allege facts from which a reasonable jury could find wrongful intent. A higher standard would not exclude any additional frivolous or groundless cases. At the same time, it is not so stringent as to dismiss meritorious claims that otherwise would be entitled to reach the jury, if supported by admissible evidence.

Nevertheless, Petitioner urges this Court to impose such a higher standard, one that would reword § 78u-4(b)(2) to require that the complaint demonstrate the "substantial merit" of plaintiff's claim of scienter. Pet. Br. at 23. Although Petitioner reiterates that phrase throughout its brief, Amicus is unable to discern that it offers any greater guidance to federal judges applying the statute. Nor does the Solicitor General's alternative, redefining "strong inference" to mean a "high likelihood" that defendant possessed the requisite scienter. Br. for the United States at 10, 15 & 20.

To the extent that these proposed formulations would result in dismissal of cases where "a reasonable person could infer that the defendant acted with the required intent," they raise a real danger of violating the jury right guaranteed by the Seventh Amendment, as the court below recognized. *See* 437 F.3d at 602.

II. THE COURT OF APPEALS' STANDARD IS CONSISTENT WITH THE SEVENTH AMENDMENT.

A. Seventh Amendment Is Implicated by Heightened Pleading Standards.

Amicus disagrees with Petitioner and the Solicitor General that "the Seventh Amendment is not implicated by the Reform Act" pleading requirements. Pet. Br. at 42. *See also* Br. for the United States at 29 ("Heightened pleading requirements have . . . not been thought to raise serious Seventh Amendment problems.").

The Solicitor General relies chiefly on this Court's decision in *Fidelity & Deposit Co. v. United States*, 187 U.S. 315 (1902). The United States sued Fidelity as a surety on a contract between a builder and a supplier that was allegedly breached. The applicable rule obliged the parties in contract actions to submit sworn affidavits including, from the defendant, an affidavit "specifically stating also, in precise and distinct terms, the grounds of his defense, which must be such as would, if true, be sufficient to defeat the plaintiff's claim." *Id.* at 318. Fidelity's affidavit raised no valid defense, but merely stated that it had no knowledge of the underlying contract, yet demanded a jury trial.

This Court's decision upholding judgment for the plaintiff does not suggest that pleading requirements do not raise Seventh Amendment concerns. First, the rule at issue in *Fidelity* was not one of heightened pleading requirements, but rather a rule authorizing summary judgment. Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Liability Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial Commitments?*, 78 N.Y.U.L. Rev. 982, 1018 (2003). Moreover, Justice McKenna, for the Court, recognized that Seventh Amendment concerns were implicated, declaring, "If it were true that the rule deprived the plaintiff in error of the *right* of trial

by jury, we should pronounce it void without reference to cases." 187 U.S. at 320. "But it does not do so," he added. Fidelity had simply failed to state the grounds of a defense that would make an issue for a jury to decide. *Id.*

Petitioner relies on *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), where this Court "limit[ed] the range of permissible inferences" that a jury may draw under substantive antitrust law. The Court held that no reasonable jury could infer a predatory price-fixing conspiracy from evidence that would require the jury to find that defendants held prices below market level, losing money for more than two decades with no little prospect of controlling the market or even recovering their losses. Justice Powell, writing for the Court, stated that such an "implausible" claim, "one that simply makes no economic sense," could not support a finding of an illicit conspiracy under § 1 & § 2 of the Sherman Act. *Id.* at 587.

Petitioner fails to see *Matsushita's* key application to this case. If Congress or this Court were to elevate the substantive proof requirements (or narrow the permissible inferences) necessary for a reasonable jury to find for the plaintiff, a heightened pleading requirement that mirrored the heightened proof requirement would not infringe upon the right to a jury trial. For example, if Congress required that proof of fraudulent intent be established by clear and convincing evidence, a requirement that the complaint allege facts sufficient for a reasonable jury to find intent by clear and convincing evidence would deprive no plaintiff of the right to submit his or her case to the jury. *See Anderson v. Liberty Lobby*, 477 U.S. at 255-56.

The standard adopted by the court of appeals in this case is consistent with that view. The court of appeals did not hold that heightened pleading requirements necessarily violate the right to trial by jury. The conflict with the Seventh Amendment arises when, as Petitioner proposes, the pleading requirement imposes a higher burden than would be required to reach the jury under the substantive proof requirements. [3]

The Solicitor General recognizes this important point in a footnote at the end of his brief. The Solicitor General observes that if the Reform Act altered "not just the pleading standard but the substantive proof standard for scienter as well," that "would eliminate any Seventh Amendment concerns." Br. for the United States at 29 n.9.

But the PSLRA did not alter the proof requirements for establishing scienter under the Securities Act. Congress subsequently had occasion to clarify that point as it was considering the the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 (1998) (codified as amended at 15 U.S.C. § § 77-78 (2000). The Conference Report stated:

> It is the clear understanding of the managers that Congress did not, in adopting the

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[3] This Court was careful to make this distinction between proof requirements and pleading requirements in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 346 (2005) ("Our holding about plaintiffs' need to *prove* proximate causation and economic loss leads us also to conclude that the plaintiffs' complaint here failed adequately to *allege* these requirements.") (emphasis in original).

> Reform Act, intend to alter the standards of liability under the Exchange Act.
>
> . . . [T]he clear intent in 1995 and our continuing intent in this legislation is that neither the Reform Act nor S. 1260 in any way alters the scienter standard in Federal securities fraud suits.

H.R. Conf. Rep. 105-803 at 15 (1998).

Even apart from such congressional statements, it is clear from the plain text of § 78u-4(b)(2) that Congress in enacting PSLRA "did not change the scienter that a plaintiff must prove to prevail in a securities fraud case but instead changed what a plaintiff must plead in his complaint in order to survive a motion to dismiss." *Helwig v. Vencor, Inc.*, 251 F.3d 540, 548 (6th Cir. 2001).

The pleading rule in this case does not affect "mere matters of form or procedure" governing trial by jury. *Baltimore & Carolina Line v. Redman*, 295 U.S. 654, 657 (1935). Rather, it touches upon the central purpose of the Seventh Amendment, to preserve "the common-law distinction between the province of the court and that of the jury, whereby . . . issues of law are to be resolved by the court and issues of fact are to be determined by the jury." *Id.*

"[B]ecause the federal courts operate under the strictures of the Seventh Amendment," this Court is reluctant "to take steps which ultimately might interfere with the proper role of the jury." *Browning-Ferris Industries v. Kelco Disposal*, 492 U.S. 257, 279 n.26 (1989). It is therefore a "cardinal principle" that, before inquiring into whether a statute violates the Seventh Amendment, the court should "first ascertain whether a construction is

fairly possible by which the [constitutional] question may be avoided." *Tull v. United States*, 481 U.S. 412, 417 n. 3 (1987) (citing *Curtis v. Loether*, 415 U.S. 189, 192 n. 6 (1974)).

The court of appeals' standard for "strong inference" fully carries out Congress's intent to allow dismissal of baseless lawsuits and at the same time avoids conflict with the fundamental right of the jury trial.

B. The Historic Importance of the Seventh Amendment Requires that Pleading Requirements Be Construed To Preserve the Right to Trial By Jury.

The "scope and effect of the Seventh Amendment . . . perhaps more than with any other provision of the Constitution, are determined by reference to the historical setting in which the amendment was adopted." *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 339 (1979) (Rehnquist, J., dissenting). Its importance can be seen in "the passion and violence with which the civil jury was defended during the Revolutionary era and the constitutional ratification debate." Alan Howard Scheiner, *Judicial Assessment of Punitive Damages, and the Politics of Jury Power*, 91 Colum. L. Rev. 142, 146-47 (1991).

On Sept 15, 1787, as the Constitutional Convention was nearing the end of its work in Philadelphia, the delegates took up a proposal that Article III include a guarantee that "trial by jury shall be preserved as usual in civil cases." The motion failed. Edith Guild Henderson, *The Background of the Seventh Amendment*, 80 Harv. L.

Rev. 289, 294 (1966). That omission nearly doomed ratification of the new Constitution.

The new Americans viewed trial by jury as essential to self-government and were passionately committed to it. They had bitterly resented England's transfer of civil disputes from colonial courts, where local juries sat, to Vice-Admiralty courts and other non-jury tribunals administered by the Crown's judges. See Roscoe Pound, THE DEVELOPMENT OF CONSTITUTIONAL GUARANTEES OF LIBERTY 69-72 (1957). Their list of grievances against the King, justifying their break with England, included "depriving us, in many cases, of the Benefits of Trial by Jury." Declaration of Independence ¶ 20 (1776). "The struggle over jury rights was, in reality, an important aspect of the fight for American independence and served to help unite the colonies." Stephan Landsman, *The Civil Jury In America: Scenes From an Unappreciated History,* 44 Hastings L.J. 579, 596 (1993).

For that reason, many in the founding generation denounced the proposed constitution as a betrayal that implicitly abolished the civil jury, and they demanded a Bill of Rights that would preserve the civil jury from encroachment by federal judges. *See Gasperini v. Center for Humanities, Inc.,* 518 U.S. 415, 450-51 (1996) (Scalia, J., dissenting); Henderson, 80 Harv. L. Rev. at 295.

Alexander Hamilton, recognizing that the absence of a right to trial by jury in civil cases was the leading popular objection to ratification in New York and other states, sought to reassure the public that "friends and adversaries of the plan of the convention, if they agree in nothing else, concur at least in the value they set upon the trial by jury."

The Federalist No. 83, at 495 (Clinton Rossiter ed. 1961). James Iredell, campaigning for ratification of the Constitution in North Carolina, argued that any representative in Congress who, out of "folly or insanity," sought to infringe the jury right "soon would be taught the consequence of sporting with the feelings of a free people." James Iredell, Marcus, Answers to Mr. Mason's Objections to the New Constitution (1788), in 5 THE FOUNDERS' CONSTITUTION 357-358 (Philip B. Kurland & Ralph Lemer eds. 1987).

Nevertheless, as Justice Story later recounted, popular demand for a jury guarantee in the Constitution was "well-nigh preventing its ratification." Joseph Story, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES 653 (R. Rotunda & J. Nowak eds. 1987) (1833). Only after the Federalists agreed to add a Bill of Rights containing such a guarantee did the Constitution win ratification. Henderson, 80 Harv. L. Rev. at 295-98; Scheiner, 91 Colum. L. Rev. at 146-47. As Justice Story relates,

> As soon as the constitution was adopted, this right was secured by the seventh amendment of the constitution proposed by congress; and which received an assent of the people, so general, as to establish its importance as a fundamental guarantee of the rights and liberties of the people.

Parsons v. Bedford, 28 U.S. (3 Pet.) 433, 445 (1830).

The possible loss of the right to trial by jury aroused such passions because the Founders viewed it as far more than a mere mode of civil procedure. The civil jury and service on the jury was a political right of immense importance, often equated with

self-government and the right to vote. *See, e.g.*, Vidram David Amar, *Jury Service as Political Participation Akin to Voting*, 80 Cornell L. Rev. 203, 218 (1995); Akhil Reed Amar, *The Bill of Rights as a Constitution,* 100 Yale L.J. 1131, 1186-96 (1991).

The Founders considered it a "bulwark against tyranny and corruption, a safeguard too precious to be left to the whim of the sovereign, or, it might be added, to that of the judiciary." *Parklane Hosiery Co. v. Shore,* 439 U.S. 322, 343 (1979) (Rehnquist, J., dissenting). Jefferson regarded the jury as "the only anchor . . . by which a government can be held to the principles of its constitution." 3 The Writings of Thomas Jefferson 71 (Washington ed. 1861).

The Founders also looked upon the civil jury as a shield against oppression by private moneyed interests. Scheiner, 91 Colum. L. Rev. at 152. In particular, farmers, Revolutionary War veterans, and others who found themselves in debt relied upon local juries drawn from their communities to ameliorate the harshness of the commercial law in the hands of judges. Charles W. Wolfram, *The Constitutional History of the Seventh Amendment,* 57 Minn. L. Rev. 639, 671-77 (1973).

The Framers expected that "the jury would reach a result that the judge either could not or would not reach." Wolfram, *supra*, at 671. They adopted the Seventh Amendment to preserve the jury's right to do so.

The court of appeals set its standard for "strong inference" at a level that fully carries out Congress's intent to allow courts to dismiss baseless lawsuits. Indeed, it is unlikely that a higher standard – one that would dismiss allegations that,

if proved, would support a verdict for the plaintiff – would eliminate any additional "strike suits," "fishing expeditions," or coerced settlements by innocent defendants. Moreover, the court was mindful of this Court's admonition:

> Maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence that any seeming curtailment of the right to a jury trial should be scrutinized with the utmost care.

Dimick v. Schiedt, 293 U.S. 474, 486 (1935).

III. PETITIONER'S PROPOSED "PRINCIPLES" FOR REVIEWING PLEADINGS FOR A "STRONG INFERENCE" OF SCIENTER ARE CONTRARY TO THE STATUTORY TEXT AND THE SEVENTH AMENDMENT.

Perhaps recognizing that its "substantial merit" standard offers little concrete help to judges assessing the scienter allegations in a securities fraud complaint, Petitioner also urges this Court to engraft three additional "principles" onto § 78u-4(b)(2): That the court consider contrary inferences from facts outside the complaint, that the complaint allege facts demonstrating motive, and that plaintiff's inference of scienter be stronger than any competing inferences from the alleged facts. Pet. Br. at 34. Amicus suggests that none of these "principles" finds any support in the statutory text and that all infringe upon the role of the jury.

A. The Sufficiency of the Complaint Should Be Based On Plaintiff's Factual Allegations.

Petitioner would first require that the judge passing upon a motion to dismiss a securities fraud complaint "take into consideration all the facts and allegations that bear on the question, not just those facts or inferences that might be viewed as favoring the plaintiff's charge," with respect to scienter, but also "contrary inferences arising from other facts before the court." Pet. Br at 34.

One commentator has observed that "the whole idea of deciding pleadings motions on the basis of extraneous materials rather than the allegations of the complaint not only deviates from the prior practice but startles legal sensibilities." Richard L. Marcus, *The Puzzling Persistence of Pleading Practice,* 76 Tex. L. Rev. 1749, 1757 (1998). It is true that some courts have allowed judges to consider materials in addition to the complaint and the documents attached thereto,[4] where the facts are not subject to dispute. *See, e.g., Allen v. WestPoint-Pepperell, Inc.,* 945 F.2d 40, 44 (2d Cir. 1991) (a court must confine its consideration "to facts stated on the face of the complaint, in documents appended to the complaint or incorporated in the complaint by reference, and to matters of which judicial notice may be taken"); *Fecht v. Price Co.,* 70 F.3d 1078, 1080 n.1 (9th Cir. 1995) (proper to consider a document whose contents were alleged in the complaint and whose authenticity is not challenged).

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[4] Documents attached to the complaint are deemed to be a part of the pleading for all purposes. Fed. R. Civ. Pro. 10(c).

Petitioner, however, phrases its principle much more broadly, insisting that "courts must look at everything, taken together, to determine whether an assertion of scienter is weak and speculative" in light of "the entirety of what is before the court." Pet. Br. at 35. To the extent that Petitioner's "principle" would authorize judges to take into consideration factual allegations put before the court by the defendant, in the motion to dismiss or otherwise, it must be rejected.

Prior practice under both the common law and code pleading rules outlawed the "speaking demurrer" in which the defendant sought to make affirmative allegations tending to show that no cause of action was stated. Marcus, *supra*, at 1757.

Indeed, Congress has already made provision for consideration, on a motion to dismiss or for judgment on the pleadings, of materials in addition to the complaint. In that circumstance the motion is treated as a motion for summary judgment and is governed by Rule 56.[5]

It is fair to assume that, in the absence of any indication to the contrary, Congress intended that motions to dismiss under the PSLRA would continue to be governed in this fashion.

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[5] Fed. R. Civ. Pro. 12(b) provides:

> If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56.

See also Fed. R. Civ. Pro. 12(c), making the same provision for motions for judgment on the pleadings.

Regardless of whether an inference that tends to negate scienter is based on the facts alleged in the complaint or on "other facts before the court," Petitioner's "principle" undermines another, more fundamental principle: The facts alleged in the complaint are deemed to be true for purposes of the motion to dismiss under Rule 12(b)(6) and all inferences are to be drawn in plaintiff's favor. Charles Alan Wright, et al., FEDERAL PRACTICE AND PROCEDURE § 1363 (3d ed. 1998) (collecting cases).

A concrete example is Petitioner's own application of its principle to this case. Petitioner argues strenuously that Plaintiff's inference that Notebaert intentionally or recklessly exaggerated sales and demand for the company's products is rendered "extraordinarily weak, if not nonexistent" by the fact that during March and April 2001, Notebaert announced downward revisions of the company's revenue projections. Pet. Br. at 36 & 47-48. The court of appeals viewed these inferences as far weaker than defendant asserts. The court noted that the March revision was "modest" and "was attributable to lower-than-expected growth in Tellabs's CABLESPAN® business, a product unrelated to this action." 437 F.3d at 592. In announcing the April 6 revision, "Notebaert insisted that the demand for the TITAN 6500 was "very strong" and explained that the only reason for the downward projections was that Tellabs's customers were pushing orders back from the first to the second quarter of 2001." *Id.* at 593.

Where the complaint alleges facts from which a reasonable jury could infer scienter, it is the exclusive province of the jury to determine whether

plaintiff's showing is outweighed by other inferences, or inferences from other facts.

B. Factual Allegations of Defendant's Motive To Engage In Fraud Are Not Essential To Plead Scienter.

As a second principle, Petitioner contends that allegations of the defendant's motive to engage in fraud are crucial to surviving a motion to dismiss. In this case, for example, in the absence of a factual allegation "that Notebaert personally benefited financially," the inference of willfulness or recklessness in making false statements cannot be "strong." Pet. Br. at 50.

The text § 78u-4(b)(2) gives no indication that factual allegations regarding motive are required. Indeed, "the words of the Act neither mandate nor prohibit the use of any particular method to establish an inference of scienter." *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195-96 (1st Cir. 1999).

Congress explicitly adopted the "strong inference" standard from the case law of the Second Circuit. Prior to passage of the PSLRA, the Second Circuit had required under Rule 9(b) that a securities fraud complaint allege facts giving rise to a "strong inference of fraudulent intent." *See Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979). The Second Circuit had also held that a complaint met the "strong inference" standard by alleging *either* the defendant's motive and opportunity to commit fraud or other circumstantial evidence of scienter. *See In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 268-69 (2d Cir. 1993).

The Senate Committee indicated that by adopting the Second Circuit's "strong inference"

standard, it "does not intend to codify the Second Circuit's case law interpreting this pleading standard." though it added that "courts may find this body of law instructive." S. Rep. No. 104-98 at 15 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679 at 694. The Conference Committee likewise disclaimed any intent to codify Second Circuit case law. *See* H.R. Conf. Rep. No. 104-369, at 41 (1995). According to Senator D'Amato, who managed the PSLRA on the floor of the Senate, Congress did not wish "to say precisely what evidence a party may present to show a strong inference of fraudulent intent. I think this strait-jackets the court." 141 Cong. Rec. S9201 (daily ed. June 28, 1995) (statement of Sen. D'Amato).

Accordingly, most courts hold it "sufficient for plaintiffs [to] plead scienter by alleging facts establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior." *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 534-35 (3d Cir. 1999); *accord*, *Press v. Chem. Inv. Services, Corp.*, 166 F.3d 529, 538 (2d Cir. 1999). *See also Helwig*, 251 F.3d 540, 551 (6th Cir. 2001) ("Congress did not endorse or prohibit a particular manner of pleading").

If Congress had instead intended to place a premium on particularized pleading regarding defendant's motive to an extent beyond even the most stringent pleading requirements of any circuit, it would have done so explicitly.

As a practical matter, while evidence of a personal financial motive is relevant to fraudulent intent, the absence of such evidence, particularly prior to discovery, does not point strongly to innocence. The absence of an allegation of a financial

motive does not, as Petitioner states, require the court "to infer that the defendant engaged in wrongdoing for the sheer joy of it, rather than for profit." Pet. Br. at 36. A corporate executive engaging in securities fraud may well take steps to disguise or hide his own trading from public view.

A plaintiff who has not unearthed evidence of personal trading activity, but can allege sufficient other circumstantial evidence yielding a strong inference of fraudulent intent, should not be dismissed on the basis of an artificial "principle" of pleading.[6]

C. The Inference of Scienter Need Not Be the Strongest Possible Inference From the Alleged Facts.

As a third principle, Petitioner argues that an inference of scienter cannot be "strong" if "the claimed culpable inference appears no more plausible than alternative, innocent inferences." Pet. Br. at 37. In other words, if equally strong opposing inferences may be drawn from plaintiff's alleged facts, the case must be dismissed. The Solicitor General espouses the same position. *See* Br. for the United States at 26 ("Plainly, therefore, if the alleged facts give rise to two seemingly equally strong [competing] inferences, a court must conclude that the inference of scienter is not itself 'strong.'") (internal quotation and citation omitted).

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[6] In *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), on which Petitioner relies, this Court specified that the lower court was free to consider other evidence that would permit the finder of fact to find that defendants conspired to hold down prices "despite the absence of any apparent motive." *Id.* at 597.

This "principle" does considerable violence to the statutory text, rewriting "strong inference" to mean the "strongest possible inference."

As the court of appeals indicated, such a gloss on the pleading requirement also infringes upon a plaintiff's right to trial by jury. If the alleged facts would support a jury finding of scienter, the plaintiff is entitled to reach the jury, regardless of the judge's view that a different interpretation of the facts is as strong. *See* 437 F.3d at 602. The Tenth Circuit has taken the same view:

> Faced with two seemingly equally strong inferences, one favoring the plaintiff and one favoring the defendant, it is inappropriate for us to make a determination as to which inference will ultimately prevail, lest we invade the traditional role of the factfinder.

Pirraglia v. Novell, Inc., 339 F.3d 1182, 1188 (10th Cir. 2003).

Petitioner does not directly address this clear transgression of the boundary between the roles of the judge and jury. Instead, Petitioner seeks support for its principle in two decisions by this Court reviewing summary judgment rulings in antitrust cases: *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986), and *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984). Neither supports the notion that the judge may take from the jury a case in which a reasonable jury could find for the plaintiff.

This Court ruled in *Matsushita* that ordinary, possibly innocent actions by defendants, such as setting prices at a level that took business away from competitors, does not, by itself give rise to any

inference under substantive antitrust law that they were engaged in a predatory pricing conspiracy. 475 U.S. at 588. Without additional evidence that would permit a jury to find the existence of a conspiracy, there was no issue of material fact for the jury, and summary judgment was appropriate. *Id.* at 597-98.

Similarly, the Court in *Monsanto* ruled that the possibly innocent act of terminating a low-price distributor following complaints by other distributors does not, standing alone, give rise to an inference of an illegal conspiracy. In *Monsanto,* however, there *was* additional evidence supporting plaintiff, including statements in a company newsletter and testimony regarding the distributors' complaints. Defendant Monsanto drew the opposite inference from the newsletter and testimony: that Monsanto acted innocently. This Court responded, "The interpretation of these documents and the testimony surrounding them properly was left to the jury." *Id.* at 766 n.11. The Court added, "The choice between two reasonable interpretations of the testimony properly was left for the jury." 767 n.12.

Moreover, Petitioner's principle is unnecessary to carry out Congress's purpose in enacting the PSLRA, as its application in this case shows.

Petitioner attributes conflicting inferences to "ambiguous pleadings" by plaintiffs. As examples, Petitioner points to the allegation that Notebaert gave upbeat sales projections in March 2001 for the TITAN 5500, though the company-commissioned Probe Research Report, completed in "early 2001," indicated weakening sales. Pet Br at 46. The complaint also alleged that Notebaert's March 8, 2001 statements were knowingly false in view of the information contained in a "March 2001" internal

report. Pet. Br at 47 n.22. Both allegations are ambiguous, Petitioner contends, because the complaint does not indicate whether the documents had been completed and read by Notebaert prior to making the allegedly misleading statements. Pet. Br. at 46 & 47 n.22.

These and other examples cited by Petitioner are ambiguous because important facts are missing – facts that, as is often the case – are in the exclusive control of the defendant. Petitioner argues that dismissal is required to serve "the core purpose of the Reform Act." Pet. Br. at 37.

To the contrary, as Professor Marcus explains, this is the kind of case in which dismissal is *not* necessary. Rule 12(b) allows the court to treat the motion as one for summary judgment, to give the parties "reasonable opportunity" to present pertinent material, and, under Fed. .R. Civ. Pro. 56(f), to permit limited discovery. By focusing discovery on the specific allegations at issue, such as the date the defendant received a particular document, the court can eliminate the risks of broad, expensive discovery and "fishing expeditions." Richard L. Marcus, *The Revival of Fact Pleading under the Federal Rules of Civil Procedure*, 86 Colum. L. Rev. 433, 488-90 (1986). It is not necessary for the court to become involved in the weighing of competing inferences to accomplish the purposes of the PSLRA.

* * *

Within living memory of the adoption of the Seventh Amendment, Justice Story declared: "The trial by jury is justly dear to the American people. It has always been an object of deep interest and solicitude, and every encroachment upon it has been

watched with great jealousy." *Parsons v. Bedford*, 28 U.S. (3 Pet.) 433, 446 (1830).

The threat in modern times, Justice Hugo Black and Chief Justice William Rehnquist have both warned, is not outright elimination of the jury but "the gradual process of judicial erosion" of the Seventh Amendment guarantee under the guise of interpreting procedural rules. *Parklane Hosiery Co., Inc. v. Shore, supra, at* 339 (1979) (Rehnquist, J., dissenting), quoting *Galloway v. United States*, 319 U.S. 372, 397 (1943) (Black, J., dissenting). Amicus urges this Court to uphold the Seventh Circuit's fealty to the constitutional command that "the right of trial by jury shall be preserved." U.S. Const. amend. VII.

CONCLUSION

For the above reasons, the decision of the court of appeals below should be affirmed.

Respectfully submitted,

Jeffrey Robert White
Center for Constitutional
Litigation, P.C.
1050 31st St., N.W.
Washington, DC 20007
(202) 965-3500
Attorney for Amicus Curiae

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